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BEFORE THE POSTAL REGULATORY COMMISSION

WASHINGTON, D.C. 20268-0001

Annual Compliance Report, 2015 **Docket No. ACR2015**

COMMENTS OF PITNEY BOWES INC.
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I. INTRODUCTION

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments on the Annual Compliance Report for Fiscal Year 2015, filed by the Postal Service on December 29, 2015 (FY2015 ACR). These comments address: (1) the discrepancy in the cost coverage and unit contribution of First-Class Mail Single-Piece and Presort Letters / Cards, (2) First-Class and Standard Mail Automation Letters rate design, (3) the importance of the rate differential between Metered Letters and Stamped Letters, and (4) First-Class Mail Flats costing issues.

II. DISCUSSION

A. FY2015 ACR Data Confirm a Continuing Disparity in the Unit Contribution and Cost Coverage of First-Class Single-Piece and Presort Letters

The FY2015 ACR confirms that First-Class Mail Presort Letters / Cards continue to be much more profitable than Single-Piece First-Class Mail Letters / Cards. In FY2015, the unit contribution for First-Class Mail Presort Letters / Cards was 26.6 cents, 3.6 cents greater than the 23.0 cent unit contribution of Single-Piece First-Class Mail Letters / Cards. *See* USPS-FY15-1. Public-FY15CRA, "Cost1." The FY2015 ACR data also confirm a lack of correspondence in the cost coverage between Presort Letters / Cards and Single-Piece Letters / Cards. For FY2015 the cost coverage for Presort Letters / Cards is 318.9 percent, as compared to the cost coverage for Single-Piece Letters / Cards of 186.0 percent. *See id.*

As shown in Table 1 below, this inequality in unit contribution and cost coverage has existed since at least 2008 when the Postal Service began reporting costs and revenues by product.

Table 1. Single-Piece Letters / Cards and Presort Letters / Cards Unit Contribution and Cost Coverage (FY2008-FY2015)[1]				
	Single-Piece Letters/Cards Unit Contribution	Presort Letters/Cards Unit Contribution	Single-Piece Letters/Cards Cost Coverage	Presort Letters/Cards Cost Coverage
FY 2008	$0.169	$0.218	167.1%	298.1%
FY 2009	$0.171	$0.223	164.9%	290.4%
FY 2010	$0.174	$0.229	164.0%	295.9%
FY 2011	$0.170	$0.232	161.2%	298.8%
FY 2012	$0.181	$0.233	165.9%	292.0%
FY 2013	$0.191	$0.246	169.7%	310.5%
FY 2014	$0.208	$0.260	174.8%	320.2%
FY 2015	$0.230	$0.266	186.0%	318.9%

The continuing disparity in unit contribution and cost coverage harms the Postal Service financially and discourages the growth and retention of the most profitable First-Class Mail products. [2]Under the CPI price cap, the overall amount of First-Class Mail revenue is limited, but the contribution that revenue produces is not. The Postal Service should use its pricing flexibility to rebalance the cost coverage and unit contributions among First-Class Mail products by lowering prices on more profitable and price sensitive Presort letters. *See* Econometric Demand Equation Tables for Market Dominant Products as of January, 2016 (Filed Jan. 20, 2016). Doing so would increase the volume of Presort letters, which would improve the Postal Service's financial position, and create a more equitable price schedule.

[1] *See* USPS-FY15-1, Public-FY15CRA.xls, "Cost1"; USPS-FY14-1, Public_FY14CRA, "Cost1"; FY2013 ACR at 10, Table 1: First-Class Mail Volume, Revenue, and Cost by Product; FY2012 ACR at 8, Table 1: First-Class Mail Volume, Revenue, and Cost by Product; FY2011 ACR at 16, Table 1: First-Class Mail Volume, Revenue, and Cost by Product; FY2010 ACR at 18, Table 1: First-Class Mail Volume, Revenue, and Cost by Product; FY2009 ACR at 22, Table 1: First-Class Mail Volume, Revenue, and Cost by Product; FY2008 ACR at 18, Table 1: First-Class Mail Volume, Revenue, and Cost by Product.

[2] A primary driver of the contraction in the difference in the unit contribution and cost coverage for First-Class Mail Single-Piece and Presort Letters in FY2015 is the one-time redistribution of carrier street time costs. *See* Docket. No. RM2015-7, Order No. 2792 (Oct. 29, 2015).

B. First-Class Mail and Standard Mail Automation Letter Rate Designs Continue to Send Inefficient Pricing Signals

The FY2015 ACR shows a passthrough (115 percent) for the First-Class Mail AADC Letters discount that is above 100 percent, *see* USPS-FY15-3, FY15 3 Worksharing Discount Tables.xls, “FCM Bulk Letters, Cards,” while the discount for First-Class Mail 5-Digit Automation Letters passes through only 69.4 percent of the costs avoided. *See id.* The current Standard Mail Automation Letters rate design follows the same pattern -- the AADC and 5-Digit passthroughs are 140 percent and 65.4 percent, respectively. *See* USPS-FY15-3, FY15 3 Worksharing Discount Tables.xls, “Standard Mail Letters.”

The Postal Service observes that the First-Class Mail AADC Letters discount is above 100 percent using the exigent prices, but would fall back to 100 percent using the CPI prices without the exigency surcharge. *See* FY2015 ACR at 10. That is correct as far as it goes, but the expiration of the exigency surcharge will affect many rate relationships. For example, if the exigency surcharge expires, the passthrough underlying the 2.3-cent First-Class Mail 5-Digit Automation Letter discount is only 63.9 percent.

As a general matter, Pitney Bowes agrees that adjustments to workshare passthroughs should be considered “over time” to avoid disruptions in rate relationships, *see* FY2015 ACR at 7, but that time horizon should not be indefinite. And as demonstrated in Table 2, the history reflects a persistent practice of setting discounts below avoided costs.

Table 2. 5-Digit Automation Letter Passthroughs (FY2008-FY2015)[3]		
	First-Class Mail	Standard Mail
FY 2008	90.4%	89.1%
FY 2009	84.6%	90.0%
FY 2010	84.6%	90.0%
FY 2011	100.0%	94.7%
FY 2012	96.0%	90.0%
FY 2013	82.8%	95.0%
FY 2014	80.6%	81.8%
FY 2015	69.4%	65.4%

Table 2 illustrates that the rate design for 5-Digit Automation Letters continues to move farther away from full recognition of the costs avoided by the Postal Service. Commission Rule 3010.14(b)(6) requires the Postal Service in any rate adjustment filing to explain discounts that are set "substantially" below 100 percent of avoided costs and to explain any relationship between discounts that are above and those that are below avoided costs. 39 C.F.R. § 3010.14(b)(6). The Commission should require the same explanation be provided as part of the annual compliance review. Here, no explanation is provided for a First-Class Mail 5-Digit Automation Letters discount which, at 69.4 or 63.9 percent, is inarguably set "substantially" below avoided costs.

The Postal Service's decision to set the 5-Digit Automation Letters discount below avoided costs will result in increased costs to mailers. Increased costs will discourage mail use. A reduction in mail use will, in turn, reduce Postal Service revenue and contribution. The 5-Digit Automation Letters discount is the most important price within First-Class Mail. It affects over 90 percent of all First-Class Mail Presort letters. Setting the discount below avoided costs fails to adequately compensate mailers performing the work to qualify for the 5-Digit

[3] FY15 3 Worksharing Discount Tables.xls, "FCM Bulk Letters, Cards" and "Standard Mail Letters"; FY 2014 Annual Compliance Determination (ACD) at 12, 18; FY 2013 ACD at 18, 30; FY 2012 ACD at 83, 120; FY 2011 ACD at 98, 124; FY 2010 ACD at 87, 111; FY 2009 ACD at 70, 91; FY 2008 ACD at 52, 68.

Automation rate and fails to provide the appropriate incentive for mailers to convert mail from AADC / 3-Digit to 5-Digit.

The Postal Service's persistent practice of setting discounts below avoided costs is inconsistent with the objectives and factors of the Postal Accountability and Enhancement Act. Regularly setting workshare discounts below avoided costs fails to achieve the objectives of the modern rate system described in section 3622(b)(1)("maximize incentives to reduce costs and increase efficiency"), and section 3622(b)(5)("to assure adequate revenues, . . . to maintain financial stability"). 39 U.S.C. §§ 3622(b)(1) and (5). Regularly setting workshare discounts below avoided costs also fails to take into account the modern rate system factors described in section 3622(c)(4)("the available alternative means of sending and receiving letters and other mail matter at reasonable costs"), section 3622(c)(5)("the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service"), and section 3622(c)(12)("the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services"). 39 U.S.C. §§ 3622(c)(4), (5), and (12).

Setting discounts below avoided costs also raises competition policy concerns because it has the effect of excluding more efficient providers (in-house mail preparation or mail service providers) from competitive upstream services (presorting, prebarcoding, handling, or transportation of mail).[4] Because the antitrust laws do not cover market dominant products, the Commission must play a more active role to ensure fair competition in these upstream markets.

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[4] *See* Docket. No. ACR2011, Comments of John C. Panzar on behalf of Pitney Bowes Inc. (ACR2011 Panzar)(Feb. 3, 2012) at 5 ("Reducing discounts below Postal Service avoided costs for any reason is a form of exclusionary pricing. This vertical price squeeze would exclude more efficient competitors from performing upstream services. This would have a short-term negative effect on the productive efficiency.")

For these reasons, the Commission should require the Postal Service to set workshare passthroughs as close as practicable to 100 percent of the costs avoided. Doing so would promote efficiency, lower the total combined costs for mailers, and encourage the retention and growth of its most profitable products.

The Commission has long recognized the importance of setting workshare discounts equal to avoided costs to maximize efficiency.[5] Citing statutorily imposed limitations on the scope and timing of the proceeding, the Commission has been reluctant to revise its workshare rules in the context of its annual compliance determination when Pitney Bowes has urged it to do so.[6] There will be no such limitations in the upcoming mandatory 10-year review of the modern rate system. *See* 39 U.S.C. § 3622(d)(3). The statute provides sufficient authority for the Commission to address this issue fully now, as previously urged by Pitney Bowes, or at that time.

C. A Separate Meter Rate is Positive for Small and Medium-Sized Business Mailers

The metered letter rate category continues to serve several important functions. It is the single-piece benchmark for calculating First-Class Mail Automation Letter prices. It allows the Postal Service to segment its retail and commercial single-piece customers in a revenue-neutral way by deaveraging single-piece prices. It provides an incentive for small and medium-sized business mailers to use the mail in new ways to grow their businesses. And it benefits the Postal Service by encouraging single-piece mailers to use a more efficient, secure payment channel.

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[5] *See e.g.,* Docket No. ACR2014, Annual Compliance Determination Report (Mar. 27, 2015) at 69 ("The Commission notes that passthroughs below 100 percent send inefficient price signals to mailers. Therefore, it encourages the Postal Service to adjust discounts to bring passthroughs closer to 100 percent."); Docket No. RM2007-1, Order No. 43 (Oct. 29, 2007) at 41 (recognizing that the Commission has used efficient component pricing as a "guiding principle" in rate design to promote productive efficiency).

[6] *See e.g.,* Docket No. ACR2011, Annual Compliance Determination Report (Mar. 28, 2012) at 102 ("Panzar's analysis, . . . is beyond the scope of this proceeding. The issue of whether the Commission's rules governing workshare discounts should be modified may be pursued, if appropriate, in a rulemaking proceeding.").

Consistent with the experience of international posts that have introduced channel-based pricing to incentivize metered mail, anecdotal feedback from U.S. meter customers confirms that small and medium-sized businesses increase their postage spend (meter through-put) or slow the rate of their mail volume decline in response to pricing incentives for metered mail. A larger price differential would drive an even more favorable customer response, as has been the case in Canada where the meter incentive is significantly larger.

A meaningful price differential between the metered letters rate and the single-piece stamped letters rate benefits small and medium-sized business mailers and the Postal Service. The metered letters price differential should be continued and, at a minimum, be restored to the one-cent differential in the next price adjustment.

D. First-Class Mail Flats Costs

As explained in Pitney Bowes's comments in Docket No. RM2011-3, the Postal Service's Cost and Revenue Analysis likely overstates the cost of First-Class Mail Presort Flats, thereby understating the cost difference between Single-Piece and Presort Flats. *See* Docket. No. RM2011-3, Comments of Pitney Bowes Inc. (Feb. 18, 2011) at 2-3. Pitney Bowes again urges the Postal Service to improve the First-Class Mail Presort Flats costing methodology for future Annual Compliance Reports.

III. CONCLUSION

Pitney Bowes appreciates the Commission's consideration of these comments.

Respectfully submitted:

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